Office of Chief Counsel
Internal Revenue Service
memorandum

CC:SB:2:PIT:EFPeduzzi
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Via Facsimile, Regular Mail

date: August 22, 2006

to: W. Ricky Stiff
Chief, Excise Tax Program

thru: Tim Torri
Group Manager

thru: Robert Cirilli
Revenue Agent

from: Edward F. Peduzzi, Jr.
Associate Area Counsel (Pittsburgh)
(Small Business/Self-Employed)

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subject: [redacted]

This responds to your memo dated September 12, 2005, requesting advice regarding the above captioned entity and received in this office on April 20, 2006. This memorandum should not be cited as precedent.

ISSUE

Whether [redacted] is liable for federal excise tax [FET] under I.R.C. § 4081(a)(1)(A), Treas. Reg. §§ 48.4081-1(b), and 48.4081-1(c)(3) on the sale of [redacted] gallons of butane sold to a marketer known as [redacted] during the years [redacted]

CONCLUSION

It is the opinion of this office that the butane sold by [redacted] to [redacted] in [redacted] should be considered as a gasoline blendstock and therefore subject to FET under Treas. Reg. § 48.4081-1(c)(3). Under the facts of the case as we understand them, the butane at issue was used to produce finished gasoline by [redacted] without further processing and thus the exception in Treas. Reg. § 48.4081-1(c)(3)(ii) is not applicable in this case.

FACTS

This case comes to us after the second Appeals consideration and subsequent feedback pursuant to IRM 8.2.1.2.2 for consideration of new matter introduced by [redacted] at the second Appeals consideration.

The history of this case began with a lead from a revenue agent who was examining [redacted] In [redacted] sold butane to [redacted] At the time of the audit of [redacted] it had been the government's position that, since [redacted] bought the butane from [redacted] refiner [redacted] would be liable for the FET on its subsequent sale of the butane to [redacted] which was a taxable fuel registrant. However under TAM [redacted] it was ruled that [redacted] would be liable only if the sales from [redacted] were exempt. Since [redacted] was not a taxable fuel registrant at the time of the sales, [redacted] was not liable for the FET notwithstanding the fact that [redacted] did not receive a certificate from [redacted] Hence [redacted] would be liable for the tax, unless the butane needed further refinement prior to being used as a blendstock.

[redacted] originally asserted two defenses: (1) The penalties for nonregistration were draconian and (2) The butane could not be used without further processing as a blendstock and hence would be nontaxable. The Appeals Officer dismissed argument (1) as being incompatible with the law and accorded little weight to argument (2) because the only facts presented by [redacted] were that another customer, [redacted] had given [redacted] a statement saying that the butane that [redacted] bought from [redacted] in the same time period had to undergo further processing before it could be used as a blendstock to produce finished gasoline. However, [redacted] had used the butane it purchased for heating purposes; moreover, there was no evidence linking the samples tested by [redacted] with the butane at issue.

At [redacted] request, the Appeals Officer allowed more time, and [redacted] subsequently came in with a defense hitherto unmentioned in the case. This was the testimony of [redacted] showed [redacted] to be a Chemical Engineer who had worked in "various engineering and executive capacities with a number of energy companies, primarily responsible for gas processing and fractionalization facilities." [redacted] asserted that, starting in [redacted] worked at [redacted] facility on a number of consulting assignments.

[redacted] now asserts that, based on "plant samples" from the [redacted] facility [redacted] has currently analyzed, *via computer simulation,* the product produced in [redacted] at the [redacted] facility, which produced the butane at issue here. The [redacted] facility apparently has two towers, or fractionators, one of which must have been present when [redacted] purchased the facility from [redacted][1]. According to

[1] In its protest letter dated October 24, 2002, [redacted] stated the following: "In [redacted] decided to get out of the shallow oil business and [redacted] purchased all of their operations in [redacted] counties. With the properties in [redacted] was included a gas stripping plant. This plant is the center of this assessment."

[redacted] what emerges is a commercial propane product and a "B-G (butane and gasoline) product."

According to [redacted] the B-G product cannot be used as blendstock because of its octane number and its vapor pressure reading --- the gasoline portion has an octane number of [redacted] and vapor pressure of [redacted] and the mixture has a vapor pressure rating of [redacted] states that the octane number is "not suitable for blending" but he does not say why. As to the vapor pressure reading [redacted] asserts that both are too high and as such represent too much volatility, and therefore "neither the B-G stream as a whole nor the gasoline stream separately were blendable as a result of their respective vapor pressures."

[redacted] data and findings were sent to the [redacted] labs in [redacted] for confirmation. The lab simply came back to say that without more it could not dispute the simulated analysis.

In the administrative file there is a questionnaire sent out to [redacted] parent of [redacted] on [redacted] which was in response to the request for more information from Branch 8, P&SI, which had closed its file on the first submission of the TAM due to insufficient information. In the questionnaire [redacted] was asked about the butane purchased from [redacted] By response dated [redacted] affirmed that the butane purchased from [redacted] was received by the [redacted] at its refinery in [redacted] and that the butane was in fact used in the production of finished gasoline and that further processing of the butane was NOT required in order for it to be used in the production of finished gasoline. The questionnaire, the response and the transmittal letter are attached to this opinion.

This office recently inquired of [redacted] as to how much butane it had purchased from [redacted] in [redacted] was slow in responding because the information was contained in an old [redacted] data retrieval system that had been replaced in [redacted] However, [redacted] finally replied that it had employed a "vendor" search and had entered [redacted] The result of that search was that, during the time period starting several years before [redacted] and ending in the year [redacted] had purchased butane from [redacted] only in [redacted] of the year [redacted] and the total gallonage was [redacted] gallons of butane.

[redacted] records show that it sold [redacted] gallons of butane to [redacted] and [redacted] The revenue agent who initially did the audit of [redacted] indicated in his excise tax lead memo that [redacted] records showed a purchase of butane from [redacted] of [redacted] gallons in [redacted] and [redacted] gallons in [redacted] totaling [redacted] gallons.

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[2] The [redacted] employee was not clear exactly when the [redacted] System was first employed, but opined that it was well before [redacted].

Lastly, the excise agent asserts that [redacted] was an employee of [redacted] when [redacted] owned the [redacted] facilities. When [redacted] purchased the operation and wells from [redacted] did not want to be an employee of [redacted] but rather he insisted that [redacted] contract with his newly-formed company, [redacted] to provide services on a consulting basis.

ANALYSIS

The most compelling evidence in this case seems to have been miscomprehended or possibly unnoticed by the Appeals Officer. This is the questionnaire which was sent to [redacted] and its response as recited above. In his report, the Appeals Officer renders his analysis of the case. In the first portion of his report the analysis is heavily pro-government; after the introduction of the [redacted] material his analysis becomes decidedly adverse to the government. He ends his analysis by saying: "If the taxpayer can prove that its butane needed further processing then the TAM becomes a moot point since the TAM is based on finding of fact, whether true or not, that the butane needed no further processing."

This ultimate finding by the Appeals Officer is predicated on an apparent misconception regarding the information obtained via the TAM questionnaires. In the pro-government portion of his report, the Appeals Officer had this to say: "I noted that during the processing of the private letter ruling [redacted] was asked if further processing was involved and the response in total was 'no.' To my knowledge there was no further probing of this aspect and no other information is available."

In the government-adverse section of his report, the Appeals Officer stated:

> More importantly now however, is whether the product sold needed further processing before it could be blended. This is a factual determination that is made on the available evidence. The significance of the TAM in this regard is not relevant since it was accepted based on *representations of* [redacted] that the purchased butane did not require further processing. As such it is imperative that Compliance now address this issue.

Appeals Transmittal and Case Memo dated April 22, 2005 (emphasis supplied).

In fact, the representations were made by [redacted] and not by [redacted] In his report on the resubmission of the TAM the Revenue Agent stated that the butane needed no further processing, and this was based on [redacted] response to the questionnaire. Thus, in ultimate fact the TAM was then at least partially based on the representations of [redacted] that the butane needed no processing. Hence, the focus of the TAM was on the 637 registration requirements only and not on the blendstock exception.

Further inquiry by this office of [redacted] produced confirmation that [redacted] had indeed purchased gallonage of butane from [redacted] during the period under consideration. [redacted] had represented that it had purchased butane from [redacted] at various times during the periods at issue and had stored the butane at its [redacted] facility. [redacted]

further represented that during the audit periods in question it sold butane to [redacted] Refining with deliveries to [redacted] and to one other refiner. These representations were confirmed by [redacted]

There seems to be a discrepancy between [redacted] purchase records and the sales records of [redacted] namely a quantity of [redacted] gallons. The first case agent auditing [redacted] using the records of [redacted] showing purchases from [redacted] scheduled this amount as having been sold by [redacted] to [redacted] in [redacted] However, schedules prepared by the excise agent, using [redacted] sales records of sales to [redacted] show no sales of butane in [redacted] However [redacted] records show a purchase of [redacted] gallons in [redacted] of [redacted] from [redacted] Hence the first case agent's schedules more probably than not show the correct gallonage. Using either agent's schedule leads to the inescapable inference that [redacted] purchased all or a large portion of [redacted] inventory in [redacted] an inventory that had been supplied by purchases from [redacted]

Thus the TAM was actually predicated on actual facts, supplied by [redacted] that the butane in question was used as a blendstock without further processing, and not on conjectural representations of [redacted] as contemplated in the Appeals Officers report.

Regarding the excise agent's observation that there should be continuity regarding tax treatment of butane as between [redacted] and its successor [redacted] the Appeals Officer accepted [redacted] explanation that due to the enormity of [redacted] enterprise it is impossible to determine the source of the butane. However, this is rebutted by [redacted] earlier statement shown in footnote one above. Based on this statement at least some of the butane sold by [redacted] must have come from the [redacted] facility. Given that [redacted] always sold its butane subject to tax, the [redacted] butane sold by [redacted] must also have been sold subject to tax. Furthermore, [redacted] as a former employee of [redacted] must have known this fact.

Regarding the findings of [redacted] our first observation is that not much credibility should be given to this hastily-assembled, 11th hour, desperate attempt to create the reality that the butane sold "needed" to be further refined before being used as a blendstock. Primarily, we have no idea of what data was used in his workup[3]; nor do we have any confidence rating as to the accuracy of a simulation done by his computer modeling. Ultimately, [redacted] findings mean nothing when compared against the reality of [redacted] response that [redacted] in fact used the butane straightaway without further procession.[4] The successful actual usage of the butane by [redacted] renders [redacted]

[3] In the April 6, 2005, letter from [redacted] it is stated that [redacted] findings are based on "actual plant samples from the [redacted] facility;" however, it the Appeal's Officer's report it is stated that "The information [redacted] is relying [sic] is from taxpayer historical data stored on his computer."

[4] For example, [redacted] indicates that an octane rating of [redacted] is not suitable for blending and that a RVP (vapor pressure) rating of [redacted] (for the gasoline portion) or [redacted] for the entire product is too high, stating that anything with an RVP over 10.5 cannot be used. However I.R.M. 4.41.1.6.4.1, Exhibit 4.41.1-19, shows the approximate characteristics of n-butane (normal butane) as having a RVP of 52.0 and an octane rating of 92. As to the octane rating the Exhibit shows that straight-run gasoline has an

theoretical assertion of nonuse as nugatory; the exclusion of Treas. Reg. § 48.4081-1(c)(3)(ii) which states that a taxable gasoline blendstock does not include any product that cannot, without further processing, be used in the production of finished gasoline does not apply in this case.

DISCLOSURE ASPECTS

This office has been in informal consultation with Attorney Donald Squires of the Disclosure and Privacy Law Section of the Chief Counsel Procedure and Administration Branch. This consultation has established four points:

(1) Usage of the questionnaire and response from [redacted] by virtue of the fact that these documents were found in the [redacted] admin file, can be used for purposes of this opinion and for further use by the Excise Tax Division and the Appeals Division. There is also no prohibition under I.R.C. §§ 6103 or 6110 from disclosing the [redacted] response to [redacted]

(2) This office's contacting [redacted] for additional information did not violate I.R.C. § 6103;

(3) Despite prior advice by this office to the contrary given to the first Appeals Officer on this case, due to the change in circumstances required in switching the point of taxation from [redacted] to [redacted] it is permissible to inform [redacted] that it was, in fact, [redacted] without violation of I.R.C. §§ 6110 or 6013; and

(4). Care must be taken however, in light of these code sections, that the Service does not directly disclose to [redacted] the identity of [redacted] as being [redacted] in the [redacted] This prohibition does not change the usage of the [redacted] papers as described in paragraph (1) of this section, since that is all transactional information excepted by I.R.C. § 6103(h)(4)(C).

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approximate octane rating of 61. The text of the IRM indicates that although this is quite low for finished gasoline, the addition of butane will increase the octane number, and the amount that can be added is regulated by the vapor pressure reading. Thus, [redacted] numbers seem to be compatible with the butane blendstock characteristics shown in the IRM rather than incompatible, as per his assertion.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office.

If there are any questions concerning the foregoing, please contact the undersigned at 412-644-3435.

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Enc: a/s